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Nos. 90-913 and 90-914

In The

Supreme Court of the United States

October Term, 1991

Board of Governors of the Federal Reserve System,
Petitioner,
v.

MCorp, MCorp Financial Inc. and
MCorp Management

and

Official Creditors' Committee of MCorp,
MCorp Financial Inc. and MCorp Management,
Respondents.

MCorp, *et al.*
Petitioners,
v.

Board of Governors of the Federal Reserve System,
Respondent.

**On Writs of Certiorari to the
United States Court of Appeals
for the Fifth Circuit**

SUPPLEMENTAL JOINT BRIEF OF MCORP, *et al.*

John D. Hawke, Jr.
Jerome I. Chapman
Howard N. Cayne *
David F. Freeman, Jr.
Michael Caglioti
Arnold & Porter
Thurman Arnold Building
1200 New Hampshire Ave., N.W.
Washington, D.C. 20036
(202) 872-6700
Special Counsel for
MCorp, MCorp Financial Inc.
and MCorp Management

Harvey R. Miller
Alan B. Miller *
Steven Alan Reiss
Kevin W. Barrett
Weil, Gotshal & Manges
767 Fifth Avenue
New York, New York 10153
Co-Attorneys for
MCorp, MCorp Financial Inc.
and MCorp Management

* Counsel of Record

(Attorneys Continued on Inside Cover)

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THOMAS W. LUCE, III
HUGHES & LUCE
2800 Momentum Place
1717 Main Street
Dallas, Texas 75201
(214) 939-5500
Co-Attorneys for MCorp, MCorp Financial Inc. and MCorp Management

ROBERT J. ROSENBERG
JOHN P. LYNCH
LATHAM & WATKINS
885 Third Avenue
New York, New York 10022
and
5800 Sears Tower
Chicago, Illinois 60606
Attorneys for Official Creditors' Committee of MCorp, MCorp Financial Inc. and *MCorp Management*

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INTRODUCTION

This Supplemental Brief is submitted to advise the Court of intervening developments that had not occurred and matter that was not available in time to be included in the Joint Brief of MCorp *et al.* filed on June 10, 1991, and to advise the Court of a material misstatement of fact contained in the Reply Brief of the Board of Governors of the Federal Reserve System (the "Board").[1]

I. THE BOARD'S CONTENTION THAT ILSA PROVIDES AUTHORITY TO IMPOSE A SOURCE-OF-STRENGTH ASSESSMENT AGAINST A BANK HOLDING COMPANY IS INCONSISTENT WITH THE POSITION TAKEN BY THE UNITED STATES BEFORE THIS COURT IN *BANK OF COUSHATTA v. FDIC*

The Board argues that the International Lending Supervision Act, 12 U.S.C. § 3907 ("ILSA"), provides a statutory basis for the Board's purported authority to levy and enforce source-of-strength assessments requiring bank holding companies to recapitalize their subsidiary banks. Board Br. at 38-39; Board Reply Br. at 16. In support of this argument, the Board relies on Section 3907(a), which authorizes the appropriate federal banking agency to set capital standards for "banking institutions" under its jurisdiction. Board Br. at 38. This argument, however, directly contradicts the position taken by the United States in its Brief In Opposition in *Bank of Coushatta* v. *Federal Deposit Insurance Corporation, petition for certiorari pending* No. 91-24, filed with this Court in August 1991.

The provision of ILSA, 12 U.S.C. § 3907(a), on which the Board predicates its claimed source-of-strength assessment authority, authorizes the appropriate federal bank

[1] MCorp is the parent company of both MCorp Financial Inc. and MCorp Management. MCorp, MCorp Financial Inc. and MCorp Management have only wholly owned subsidiaries.

regulator to establish minimum capital levels for "banking institutions" under its jurisdiction. Section 3907 also authorizes the appropriate federal bank regulator to enforce such minimum capital levels against "banking institutions" through the issuance of "capital directives." A bank holding company such as MCorp, however, is not a "banking institution" within the meaning of ILSA. 12 U.S.C. § 3902(2). The United States acknowledges this point in its Brief in Opposition in *Bank of Coushatta,* in which it affirmatively asserts that the term "banking institution" does not include a bank holding company, and that a capital directive therefore cannot be issued against a bank holding company. In the words of the United States, *"capital directives may issue only against 'banking institutions,' 12 U.S.C. § 3907(a), not bank holding companies. Therefore, a capital directive cannot impose requirements on a bank holding company such as were imposed in MCorp."* [2]

The Board's claim that ILSA provides it with authority to issue a source-of-strength assessment against a bank holding company is not only wholly unsupportable for the reasons stated in MCorp's principal brief at 43, but it also is completely inconsistent with the position taken by the United States in *Bank of Coushatta.*

II. RECENT CONGRESSIONAL DEVELOPMENTS

A. Testimony of FDIC and SEC Chairmen in Opposition to Source-of-Strength Assessment Power

Because the Board relies almost entirely on its own policy arguments in support of its alleged source-of-strength assessment authority, the Court may wish to consider the contrary views of two other federal agencies recently expressed to Congress regarding source-of-strength.

On June 20, 1991, Richard Breeden, Chairman of the Securities and Exchange Commission ("SEC"), testified

[2] Brief of the United States in Opposition, in *Bank of Coushatta* v. *Federal Deposit Insurance Corporation,* at 12 n.8 (No. 91-24, August 1991) (emphasis added).

in opposition to the legislative source-of-strength assessment proposal pending before the House Subcommittee on Telecommunications and Finance:

> The Commission is concerned that the "source of strength" provisions in H.R. 1505 could have undesirable effects on the capital markets. Under the bill FSHCs [financial services holding companies, a term replacing bank holding companies in the legislation] with undercapitalized banking subsidiaries would have to maintain consolidated capital at identified levels . . . .
>
> *These source of strength provisions would almost certainly discourage investments in depository institutions.* In this manner, the consolidated capital requirements of H.R. 1505 could reduce the intended benefits to the banking system of increasing access to outside capital and management and of authorizing FSHCs to offer broader financial services.[3] (Emphasis added.)

The SEC's position on the effects of source-of-strength assessments on our financial system echoes the oft-repeated comments of the FDIC.[4] FDIC Chairman Seidman recently testified in opposition to the source-of-strength provisions in pending legislation. In his written testimony, FDIC Chairman Seidman stated the FDIC's position on the "source-of-strength" assessment provisions as follows:

> [The FDIC has] concerns about legislatively mandating that holding companies act as a "source of strength" to their affiliated organizations. A "source of strength" requirement could undermine the goals

[3] Written Testimony of Richard Breeden, Chairman, SEC, before House Subcomm. on Telecommunications and Finance, June 20, 1991 at 30-31. Chairman Breeden also expressed concern over the potentially harmful effect that a source-of-strength requirement would have upon the capital levels of broker-dealer firms owned by bank holding companies. *Id.*

[4] *See* MCorp Br. at 29, 32, 34-36. The Board's suggestion that the FDIC has not officially taken a position on "source-of-strength" assessments is thus incorrect. Board Reply Br. at 19 n.19.

of limited corporate liability envisioned by having separate bank affiliates. Also, if such ownership burdens are mandated by Congress, they would make investments in bank equities unattractive. Right now particularly, we need to encourage investment in banks, not discourage it. Many bank stocks prior to the mid-1930's were subject to additional assessments if a bank experienced financial difficulties. Congress removed this requirement because of its negative effect on the ability of banks to raise new capital.[5]

The FDIC, like the Board, is charged with administering the Financial Institutions Supervisory Act ("FISA"), codified in Section 8 of the Federal Deposit Insurance Act, 12 U.S.C. § 1818, and ILSA, 12 U.S.C. § 3907, two of the statutes on which the Board relies for its alleged source-of-strength assessment authority. The FDIC's continuing official position that neither FISA, ILSA nor any other law provides any statutory basis for the Board's claimed source-of-strength assessment power, and the FDIC's criticism of the policy and economic wisdom of such assessments, preclude any basis for the Board's contention that *Chevron*[6] compels this Court to defer to the Board's administrative interpretation of these same banking statutes.

B. Pending Legislation

Congress repeatedly has considered and rejected various formulations of a source-of-strength assessment authority. MCorp Br. at 33-38. Congress again is considering

[5] *Financial Industry Reform and Capital Enforcement Act (H.R. 192): Hearing Bef. Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs,* at 80 (1991) (written testimony of L. William Seidman, Chairman, FDIC). Although this House hearing took place on February 28, 1991, the hearing report was not available in time to be included in MCorp's principal brief.

[6] *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

legislation that would, if enacted, for the first time since the repeal of shareholder liability in the 1930's, statutorily authorize source-of-strength assessments against bank holding companies.

This continuing congressional consideration of source-of-strength assessments demonstrates that: (1) the Board presently lacks statutory authority to impose source-of-strength assessments on bank holding companies; (2) the source-of-strength authority that Congress has under consideration is significantly more limited in scope than that claimed by the Board under its self-declared source-of-strength assessment policy; and (3) a grant of source-of-strength assessment power would involve a substantial change in current law with major economic implications and is a power that only Congress, and not this Court or the Board, properly can grant.[7]

Both the House and Senate currently are considering legislation that would grant the federal bank regulators a limited source-of-strength assessment power. Unlike the Board's unilaterally declared source-of-strength assessment power, the pending legislative initiatives are limited in scope and effect and would allow a bank holding company to choose between adding capital and divesting the bank.

The operation of one proposed limited source-of-strength assessment authority was explained by Robert Glauber, Deputy Undersecretary of Finance, Department of Treasury, when he testified regarding the Administration's bill (H.R. 1505 and S. 713):

> What we propose is that at such time as the bank would cross below the fully-capitalized threshold, which would be 8 percent in the near future, that immediately the holding company either has to fill up the capital again, get rid of the bank or subject itself to bank-like kinds of regulation.
>
> We think that is enough. There are other proposals that would allow the regulators to call back capital from the commercial firm. I think that in deciding

[7] *See generally* MCorp Br. at 29-45.

> what is a suitable set of regulations, you have to balance the need to make certain the bank won't become a ward of the Fund and cost the Fund money, and at the same time, pose an attractive opportunity for the commercial firms, which as you have suggested, have most of the capital.[8]

On July 23, the House Committee on Banking, Finance and Urban Affairs reported a bill, H.R. 6, that would grant a different, limited statutory source-of-strength power to the federal banking regulators. The House bill would require, as a condition to federal regulatory approval of an undercapitalized financial institution's capital improvement plan, that the parent company provide a written guaranty, for a period ending 12 months after the bank achieves regulatory capital compliance, that the bank will comply with the capital plan. The amount of the parent company's liability under such a written commitment, however, would be limited to the amount of money that would have been required to place the bank into regulatory capital compliance as of the date of the commitment. H.R. 6, § 131(f), 102d Cong., 1st Sess. (July 23, 1991). If the parent company failed to make such a written commitment, the capital plan could not be approved. The bank would be subject to operating restrictions, and potential forced sale of securities or divestiture, *but the parent company would not be liable to infuse capital into the subsidiary bank. See* H.R. 6, § 131(g), (i).

The House Bill also would require a "Financial Services Holding Company" ("FSHC," a term replacing "bank holding company" in the Bill) that either engages in new activities permitted by the legislation or that is controlled by a "Diversified Holding Company" ("DHC,"

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[8] *Financial Institutions Safety and Consumer Choice Act of 1991: Hearings Bef. Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs*, 102d Cong., 1st Sess. at 15-16 (Mar. 21, 1991) (testimony of Robert Glauber, Deputy Undersecretary of Finance, Department of Treasury). Although the hearing took place on March 21, 1991, the hearing report was not available in time to be included in MCorp's principal brief.

a company engaging in nonfinancial commercial activities not permitted to a FSHC), to maintain the capital of subsidiary banks. Under the House Bill, if the FSHC or DHC fails to maintain the regulatory capital of a subsidiary bank, it could be required to divest the bank. H.R. 6 § 403(m). The House Committee Report states that under the Bill, "[l]ike the FSHC, the DHC must be separately capitalized and supervised. All holding companies would have to maintain their bank's capital requirements, *or divest their ownership in the bank.*"[9] (Emphasis added.)

On August 2, the Senate Banking Committee approved a bill, S. 543, which would grant a limited statutory source-of-strength assessment power to the FDIC, but not to the Board. Under this proposal, a bank holding company's maximum assessment liability would be limited to no more than five percent of its subsidiary bank's assets. The Senate Bill would create this power by extending to the parent company (but not to nonbank sister affiliates) of an FDIC-insured bank a portion of the liability for the "cross-guaranty" assessment created by Section 5(e) of the Federal Deposit Insurance Act, 12 U.S.C. § 1815(e). Under current law, the "cross-guaranty" liability of Section 1815(e) applies only to affiliated FDIC-insured depository institutions, and not to the parent company or other nonbank affiliates. As noted above and in MCorp's principal brief, the FDIC repeatedly has stated its position that source-of-strength assessments are *not* sound economic policy and has not requested this authority from Congress.

III. BOARD MISSTATEMENT OF FACTS CONCERNING THE CONTINUING EFFECTIVENESS OF TEMPORARY CEASE-AND-DESIST ORDERS AGAINST MCORP

The Board asserts in its Reply Brief that "the relevant provisions of the Board's October 1988 temporary order, which sought MCorp's compliance with the source of

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[9] H.R. Rep. No. 157, 102d Cong., 1st Sess. at 119 (July 23, 1991).

strength policy, were suspended by the Board shortly after the order was issued, pending MCorp's negotiations with the FDIC . . . and they have no effect on MCorp." Reply Br. at 5-6 n.6; *accord* Reply Br. at 10 n.12. This assertion underlies the Board's contention that it has not yet asserted control over property of MCorp and that the "police or regulatory power" exception to the automatic stay, 11 U.S.C. § 362(b)(4), therefore should apply here. Reply Br. at 5. In fact, this assertion concerning the continuing effectiveness of the Board's three immediately effective temporary cease-and-desist orders issued against MCorp is factually incorrect.[10]

The Board issued not one but three separate temporary cease-and-desist orders in October 1988, each seeking MCorp's compliance with the source-of-strength policy, and none of which has been rescinded by the Board. Each of the three temporary cease-and-desist orders seeks MCorp's compliance with the source-of-strength policy by exercising direct control over the assets of MCorp's estate.[11] Indeed, the Board itself consistently has treated the three temporary orders as a unified "set" intended to enforce its alleged "source-of-strength" authority. For example, in its brief to the Fifth Circuit, the Board stated that it had "issued a set of temporary cease and desist orders designed to preserve its practical ability to enforce the source of strength requirements." [12]

The Board's assertion that it suspended the provisions of the Board's October 1988 temporary order apparently refers to a letter dated November 7, 1988, which temporarily "defer[red]" MCorp's obligation to comply with the third temporary order "during the time that . . . negotiations continue" between MCorp and the FDIC regarding a recapitalization of MCorp. J.A. at 184. The Board itself, however, has asserted that the deferral of MCorp's obligations under the third temporary order "did not . . . relieve MCorp of its duty to comply with the two initial temporary orders." [13] Moreover, this temporary deferral expired upon the FDIC's rejection of MCorp's recapilization proposal long ago. *See* J.A. at 203; Board Br. at 11. Since that time, the Board has not further "deferred" MCorp's obligations under any of the three temporary cease-and-desist orders, and none of the orders ever has been rescinded or withdrawn.

Indeed, subsequent to the expiration of the temporary deferral of the third temporary order, the Board confirmed the continuing effectiveness of all three temporary cease-and-desist orders in issuing the Second Amended Notice of Charges. The Second Amended Notice expressly recognizes the continuing effectiveness of all three temporary orders, stating that "[t]he provisions of this Second Amended Notice of Charges do not supersede, modify, or, any manner, affect the provisions of the Notice of Charges and of Hearing issued against MCorp . . . on March 30, 1989, *or the status of the temporary orders issued on October 19 and 26, 1988.*" J.A. at 194 (emphasis added).

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[10] The same factual error underpins the Board's argument that notwithstanding the explicit grant of jurisdiction to review an effective temporary cease-and-desist order contained in 12 U.S.C. § 1818(c)(2), *see* MCorp Br. at 27-28, there is no basis in this case "for a court to adjudicate the validity of the source of strength policy" as part of MCorp's challenge to the temporary cease-and-desist orders. Reply Br. at 10 n.12.

[11] The first two temporary cease-and-desist orders restrain the use or disposition of MCorp's assets, J.A. at 65-70, for the purpose of maintaining their availability to satisfy any source-of-strength assessment by the Board, J.A. at 63. The third temporary order requires MCorp to "take such actions as are necessary to use all of its assets to provide capital support to [MBanks] in need of additional capital," and to report to the Board with respect thereto. J.A. at 85.

[12] Board Brief in *MCorp et al.* v. *Board of Governors of the Federal Reserve System*, 5th Cir. No. 89-2816 at 6 (filed Aug. 14, 1989).

[13] Board Brief in *MCorp et al.* v. *Board of Governors of the Federal Reserve System*, S.D. Tex. No. H-89-1677 at 5 (filed May 25, 1989).

Thus contrary to the Board's assertion that the provisions of the temporary order "had been indefinitely suspended by the time of the district court action here," Reply Br. at 10 n.12, and therefore "have no effect on MCorp," Reply Br. at 6 n.6, the Board, by virtue of the outstanding temporary orders, once again will exercise immediate and direct control over the assets of the MCorp estate, unless all three temporary orders remain enjoined by the district court injunction. Therefore, the "police or regulatory power" exception does not insulate the Board's proceedings from the operation of the automatic stay under Section 362(a)(3) and (6) of the Bankruptcy Code.[14] *See MCorp* Br. at 15-17, 20-22.[15]

Respectfully submitted,

JOHN D. HAWKE, JR.
JEROME I. CHAPMAN
HOWARD N. CAYNE *
DAVID F. FREEMAN, JR.
MICHAEL CAGLIOTI
ARNOLD & PORTER
Thurman Arnold Building
1200 New Hampshire Ave., N.W.
Washington, D.C. 20036
(202) 872-6700
Special Counsel for MCorp, MCorp Financial Inc. and MCorp Management

HARVEY R. MILLER
ALAN B. MILLER *
STEVEN ALAN REISS
KEVIN W. BARRETT
WEIL, GOTSHAL & MANGES
767 Fifth Avenue
New York, New York 10153
Co-Attorneys for MCorp, MCorp Financial Inc. and MCorp Management

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* Counsel of Record

[14] Furthermore, regardless of the applicability of the automatic stay under these circumstances, the continuing effectiveness of the three temporary orders on MCorp makes clear that the court below had jurisdiction to rule on the invalidity of the Board's source-of-strength assessment policy as part of MCorp's challenge to the temporary orders. *See* MCorp Br. at 27-28.

[15] We also wish to call to the Court's attention the reversal of a decision cited in *MCorp's* Brief. MCorp's Brief cited the decision of the bankruptcy court in *FirstCorp* v. *Office of Thrift Supervision*, 144 Bankr. 484 (Bankr. E.D.N.C. 1990). MCorp Br. at 14-16. On July 12, 1991, the District Court for the Eastern District of North Carolina, citing the Fifth Circuit's decision in this case, reversed that decision. *FirstCorp, Inc.* v. *Office of Thrift Supervision*, No. 91-180-CIV-5-BR, slip op. (E.D.N.C. July 12, 1991).

THOMAS W. LUCE, III
HUGHES & LUCE
2800 Momentum Place
1717 Main Street
Dallas, Texas 75201
(214) 939-5500
Co-Attorneys for MCorp, MCorp Financial Inc. and MCorp Management

ROBERT J. ROSENBERG
JOHN P. LYNCH
LATHAM & WATKINS
885 Third Avenue
New York, New York 10022
and
5800 Sears Tower
Chicago, Illinois 60606
Attorneys for Official Creditors' Committee of MCorp, MCorp Financial Inc. and *MCorp Management*